JMI Wealth

Monthly View

December 2020

COVID 19 Continues to Disrupt

The United States and Europe had a resurgence of COVID 19 cases in November leading to a second round of lockdowns in Europe and increased social distancing in the US. This has been a headwind for current company earnings. However, share markets have looked through the current restrictions with the reported success in vaccine development boosting global markets. Three western pharmaceutical companies reported better than expected vaccine efficacy in November. Share markets rose on the news as it signals that there is an end date to the virus' impact on economies and that the time to achieving that objective is shorter. The Japanese share market rose 15% in local terms and the MSCI World Accumulation index was up 12.8% (local terms).

Australian Share Market Outperforms New Zealand

Australian and New Zealand share markets also responded positively to vaccine news and this was reinforced in Australia by the emergence of Victoria from lockdown. Victoria accounts for approximately 25% of Australia's GDP. Australian shares had their strongest month in 103 years with the ASX 200 up 10.2%. A wide range of sectors are represented on the Australian Stock Exchange and a number of stocks were direct beneficiaries of COVID 19 vaccine relief, this includes Qantas and many of the real estate investment trusts e.g. URW. The large Australian banks also staged a bounce back. With the improving economic conditions the degree of loss provisioning by banks may prove excessive, capital ratios remain robust and dividends relatively attractive. Iron ore prices have continued to hold up despite the escalating trade tensions between Australia and China, proving a positive for both Rio and BHP, the two largest iron ore producers in Australia. Increasingly it appears that the income from large mining companies will continue to hold up.

The improvement in Australian share values is occurring despite the political relationship with China deteriorating. Australian exports to China have had increasing barriers to entry imposed. Coal is one of Australia's most important trades and over 60 vessels have been prevented from entering Chinese ports as coal quality issues are addressed. Trade tensions have extended to wine exports with tariffs of between 107% and 200% imposed on all Australian wine imports into China. The effects of the trade impediments are largely confined to individual companies thus far e.g. Treasury Wine Estates but have the potential to generate headwinds for the Australian market over coming months.

New Zealand Shares Record Another Positive Month

Overall the New Zealand share market recorded another month of positive returns with the S&P/NZX 50 Gross index up 5.7% in November. The New Zealand market lifted despite A2 Milk ending the month where it started. Fisher and Paykel Healthcare the largest company on the exchange reported a record half year profit up 86%. The strong result exceeded the markets high expectations, but the ensuing share price rise only really recovered the weakness seen earlier in the month. The actual gains in New Zealand shares came from surprising quarters. Fletcher Building was up 36% in the month. The company is benefiting from the residential construction boom and has been able to significantly reduce costs. Air New Zealand in sympathy with vaccine announcements improved 28% despite the airline still burning cash and likely to receive a further capital infusion. Meridian Energy (+21%) also rebounded in November as the company continued to be a beneficiary of renewable energy index funds experiencing capital inflows.

New Zealand Monetary Policy Change

November saw some significant changes to monetary policy settings. House prices have been exceptionally strong with the New Zealand median house price up 20% year on year in October. The Reserve Bank has commenced consultation to reintroduce loan to value restrictions and the Government has proposed changing the central bank's remit to include house price stability as well as inflation and employment targets. In addition to the policy objectives the RBNZ has left the bond purchasing target unchanged and introduced the Funding for Lending (FLP) programme. The FLP is designed to reduce term investment interest rates at a retail level with the objectives of increasing consumer spending, reducing costs of business borrowing and encouraging further business investment. In conjunction with these measures the actual economic outcomes have not been as bad as the RBNZ forecast and this has led the investment market to reprice with the probability of negative interest rates being low.

The implementation of FLP implies that term investment rates will likely remain low for a considerable time. The programme is intended to remain in place for 3 years and will enable banks to initially borrow up to $28 billion at the Official Cash Rate of 0.25%. Potentially a divergence between retail and wholesale rates and near-term and long-term rates will emerge. The FLP and OCR will anchor retail rates less than 3 years. In contrast longer-term inflation expectations have risen modestly based on better than expected economic indicators.

Conclusions

The outlook for fixed interest retail investments appears to be for interest rates to remain at a low level for a prolonged period. The result is more investors re-evaluating the asset allocation to both growth assets (shares) and income assets (cash and bonds). Although many countries share markets are at historic highs this does not necessarily mean they are overvalued. Interest rates have a large impact on valuations and not having seen rates this low means any historical comparison of companies being expensive or cheap is difficult. We cannot see rates rising sufficiently to diminish the attraction of shares.

Assuming that low rates prevail for longer and that vaccine distribution aids activity levels and sentiment then the outlook for shares continues to be favourable compared to fixed interest. We believe a well-diversified portfolio of shares should provide investors a better return over the long term than holding bank deposits.

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Allocation to long-term benchmarks

Sector	Position	Comment
Cash	Underweight	Reduce cash, negligible return
Fixed Interest	Underweight	Returns expected to be low in short to medium term
Australasian shares	Neutral	Slight overweight relative to strategic asset allocation
Global Shares	Overweight	Slight overweight relative to strategic asset allocation
Property	Overweight	Increase to improve portfolio income

Indices for Key Markets

As at 30 November 2020	1 Mth	3 Mth	1 Yr	3 Yrs p.a.	5 Yrs p.a.
S&P/NZX 50 Index	5.7	7.0	12.8	16.0	15.9
S&P/ASX 200 Accumulation Index (NZD)	8.6	3.5	-2.6	5.0	8.0
MSCI ACWI Index (NZD)	5.6	2.0	5.6	8.6	10.0
S&P/NZX 90 Day bank bill Total Return	0.0	0.1	0.7	1.5	1.8

If you have any questions please contact us on +64 9 308 1450 or visit our website www.jmiwealth.co.nz